

Trade aspects of China's presence in Latin America and the Caribbean



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PE 702.572 – November 2022

EN

BRIEFING

Trade aspects of China's presence in Latin America and the Caribbean

ABSTRACT

Over the last 20 years, China has become the second largest trading partner of Latin America & the Caribbean (LAC). Between 2000 and 2020, China-LAC trade grew 26-fold from USD 12 billion to USD 310 billion. China is also among the top sources of foreign direct investment and finance for the LAC region. The impact of China in LAC is closely related to the Latin American boom in commodities extraction, and infrastructure construction. While traditional commodities continue to be important, trade in new sectors (such as minerals that are crucial for renewable energy – e.g. lithium) as well as in services, is growing rapidly. Although LAC profited from expanded economic interchange with China due to positive terms of trade effects, the long-term implications of the asymmetrical dependence of LAC countries on China remain in doubt. LAC countries have not been able to upgrade in many global value chains that rely on inputs from the region, with its technological capabilities stagnating. China has also successfully used soft power instruments to expand its influence in LAC. In reaction to these new realities, the EU should offer LAC a strategic partnership based on fair and sustainable trade and on intensified technological and political cooperation. Raw-material partnerships based on human rights and environmental sustainability should be supported. Finally, the two regions could join forces to promote a new multilateralism.

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This paper was requested by the European Parliament's Committee on International Trade (INTA).

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VERSION

English-language manuscript completed on 17 November 2022.

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1 Introduction

The rise of China as a trade powerhouse has had profound implications for global commerce over the last 20 years, with Latin America & the Caribbean (LAC) among the biggest beneficiaries.¹ Between 2000 and 2020, China-LAC trade grew 26-fold from USD 12 billion to USD 310 billion (UN Comtrade, 2022). The EU, which has long been the most important trading partner for South America and the second largest trading partner for LAC as a whole, has experienced a decrease in its market share amid China's expanding trade with LAC countries. Apart from trade, China is also among the top sources of foreign direct investment (FDI) and finance for the LAC region.

The impact of this new trading partner is closely related to the Latin American boom in agricultural and mineral commodities extraction since the late 2000s, as well as infrastructure construction throughout the LAC region. More recent data show that while commodities continue to be important, new sectors are emerging rapidly, including for instance services.

This Briefing provides an overview of China's economic engagement in the LAC region, paying particular attention to trade, bilateral FDI and infrastructure projects. Where possible, a comparative analysis with respect to EU trade and investment relations with LAC is applied. Also, the Briefing discusses the direct as well as indirect effects of growing economic relations with China on the LAC region. Finally, it provides an assessment of the growing political influence of China in the LAC region and draws conclusions on the implications of this for the EU's future approach to Latin America & the Caribbean.

2 Trade relations between the LAC region and China

Trade in goods

In 2020, the value of total trade in goods (exports + imports) between LAC and the rest of the world amounted to USD 1.75 trillion.² With a share of 18 %, China was LAC's second most important trading partner after the USA (38 %) and ahead of the EU (11 %). Intra-LAC trade accounted for 14 % of total trade in goods. The importance of the US relates mainly to Central America & Mexico, with 58 % of the total trade of these countries in 2020 being with the US, compared to only 11 % with China and 7 % with the EU. As far as South America and the Mercosur countries are concerned, China is the most important trading partner, accounting for 25 % and 24 % of total trade, respectively. The USA accounts for 15 % and 13 %, respectively, and the EU for 14 % and 15 %. Intra-LAC trade, accounting for 21 % in South America and the Mercosur countries, is of relatively high importance. In Central America and Mexico, this share is only 6 %.

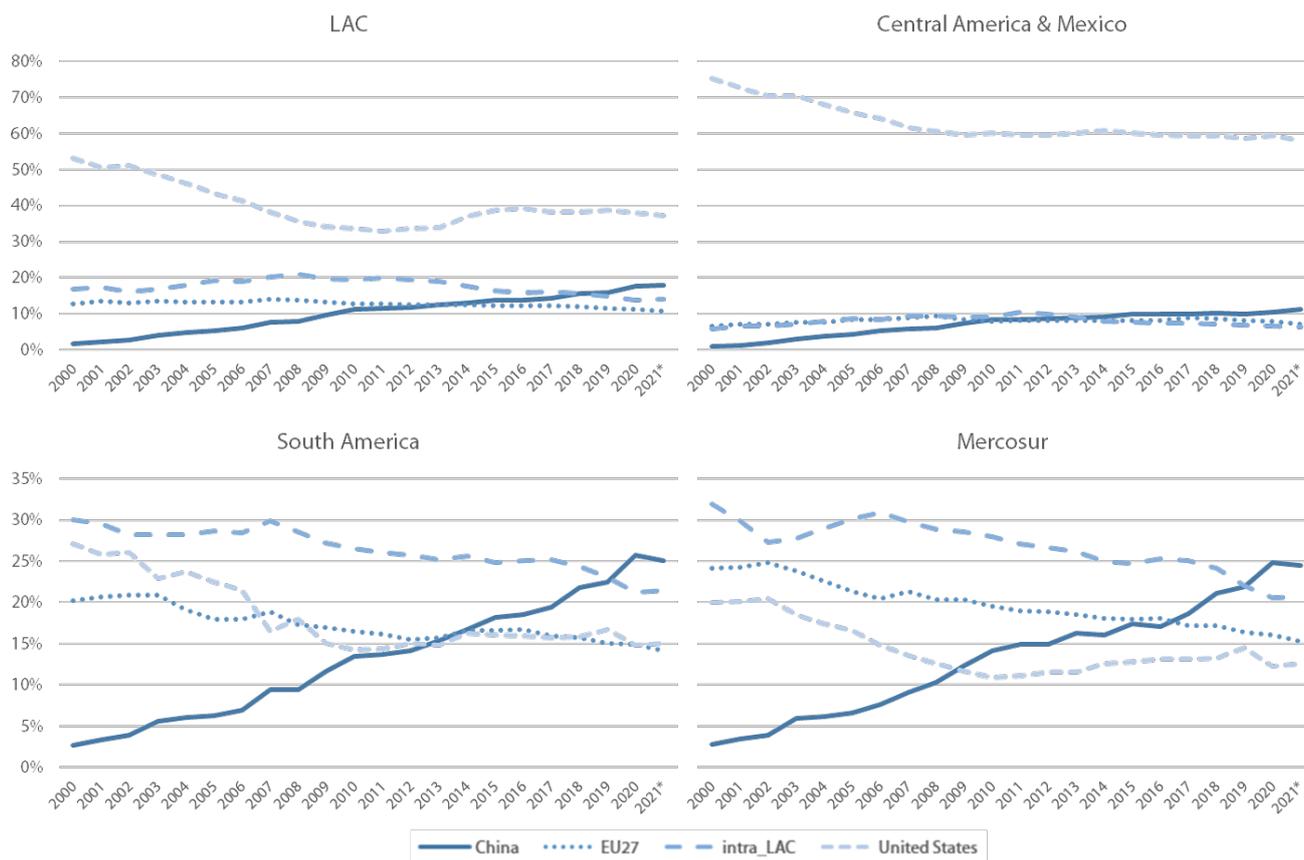
China's share in total LAC trade in goods has experienced a steep rise over the past twenty years, having been close to zero at the beginning of the century. This growth was accompanied by a significant decline in the share of trade with the USA, as well as a drop in EU and intra-LAC trade. In 2015, China became South America's most important single trading partner. Only intra-LAC trade showed a higher value until 2018 (Figure 1). Increased trade relations are also reflected in bilateral trade diplomacy. With a focus on enhancing market access, Chile (2005), Peru (2009) and Costa Rica (2011) have signed trade agreements

¹ This Briefing presents data and analysis on the LAC region in its entirety. In addition, it provides more detailed information on the sub regions of South America (Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guyana, Paraguay, Peru, Suriname, Uruguay, and Venezuela), the South American trade bloc Mercosur (Argentina, Brazil, Paraguay, and Uruguay), as well as Central America & Mexico (Belize, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, and Panama).

² All figures in this section are taken from the UN Comtrade (WITS) database and are based on imports and exports reported by LAC countries. A comparison with reported imports of China and the world from LAC regions/countries in the UN Comtrade database shows that partner countries report higher imports than LAC countries report exports. The figures should, therefore, be interpreted with caution. Differences may be due, to different reporting practices of the respective statistical authorities. For this reason, it was decided to rely predominantly on Latin American reports in order to improve data consistency.

with China. Negotiations with a series of other countries are on-going (see Annex – Table 1 for more information).

Figure 1: Share of LAC trade partners in total trade in goods (exports + imports) by regional grouping



Note: Data for 2021 is preliminary, since Peru, Uruguay and Jamaica are only included up to the year 2020. Cuba is only included until 2006 and Venezuela until 2013.

Source: Own elaboration based on UN Comtrade (WITS).

Regional differences are also reflected in the trade balance of LAC with China. In 2020, LAC had a trade deficit with China of USD 51.2 billion. This represents a decrease in comparison to 2015, when the trade deficit stood at USD 99.3 billion. The negative balance is due to a significant trade deficit experienced by Central American countries & Mexico with China, although this is partially offset by South America's trade surplus. The reduction of the overall LAC trade deficit from 2015-20 was mainly due to rising exports from South America, especially from Mercosur countries.

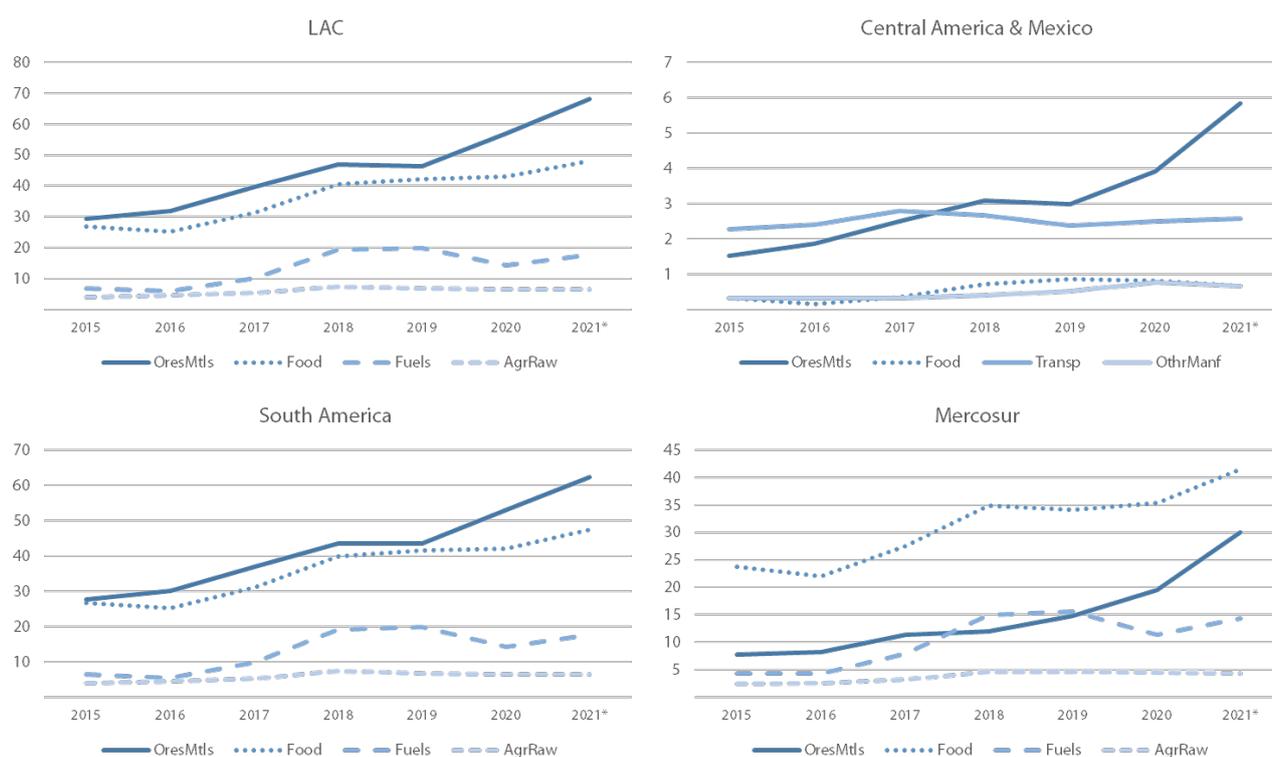
From a sectoral perspective, machinery and transport equipment, other manufactured goods and chemicals dominate imports to LAC. In 2020, they accounted for 55 %, 30 %, and 10 % of total Chinese imports to the region, respectively. This importance is also reflected in the data for the regions (South America: 52 %, 31 % and 14 %; Mercosur: 55 %, 24 % and 18 %). In Central America & Mexico, imports of chemicals are less prominent (60 %, 28 % and 5 %). A comparison with 2015 shows that while imports from China to LAC have increased, their sectoral composition has remained largely unchanged.

The opposite holds true for LAC exports to China. Here, the three dominating sectors have developed quite dynamically in recent years. Ores and metals account for by far the largest share of exports in terms of value (44 % in 2020). Their size nearly doubled from USD 29.3 billion in 2015 to USD 56.9 billion in 2020. Food products and fuels are the second and third most important exports to China, accounting for 33 % and 11 % of total LAC exports in 2020, respectively. From 2015 to 2020, food exports increased sharply from USD 27 billion to USD 43 billion. Fuel exports, in particular, increased from 2016-2019, when they almost

quadrupled from USD 4.5 billion to USD 20 billion. However, they subsequently fell to USD 14.3 billion in 2020.

These overall trends are well reflected in the figures for South America. In 2020, ores and metals, food, and fuels accounted for 44 %, 35 % and 12 % of its export portfolio. For Mercosur countries, food is still the most important export sector (48 %). Ores and metals account for 26 % and fuel for 15 % of their exports to China. With growth rates of 153 % and 164 % from 2015-20, these two sectors developed more dynamically than the food sector (+49 %). Central America & Mexico again differs from the overall trend. Ores and metals are the most important export sector (46 %), followed by machinery and transport equipment (29 %). Food (10 %) ranks third, just ahead of other manufactured goods (9 %). The most dynamic change can be seen in the ores and metals sector (growth rate of 156 % from 2015 to 2020) and in other manufactured goods (+151 %). The machinery and transport equipment sector has developed less dynamically (+9 %).³ Figure 2 shows these developments in absolute numbers by region. The figures for Central America & Mexico are largely dominated by Mexico.

Figure 2: Sectoral exports to China by region, USD billion



Note: Product classification was made according to SITC. The following categories were included: food (SITC 0+1+22+4), agricultural raw materials (SITC 2-22-27-28), ores & metals (SITC 27+28+68), fuels (SITC 3), chemicals (SITC 5), machinery & transport equipment (SITC 7), other manufacturers (SITC 6+8-68), and miscellaneous goods (SITC 9). Data for 2021 are preliminary (see Note Figure 1).

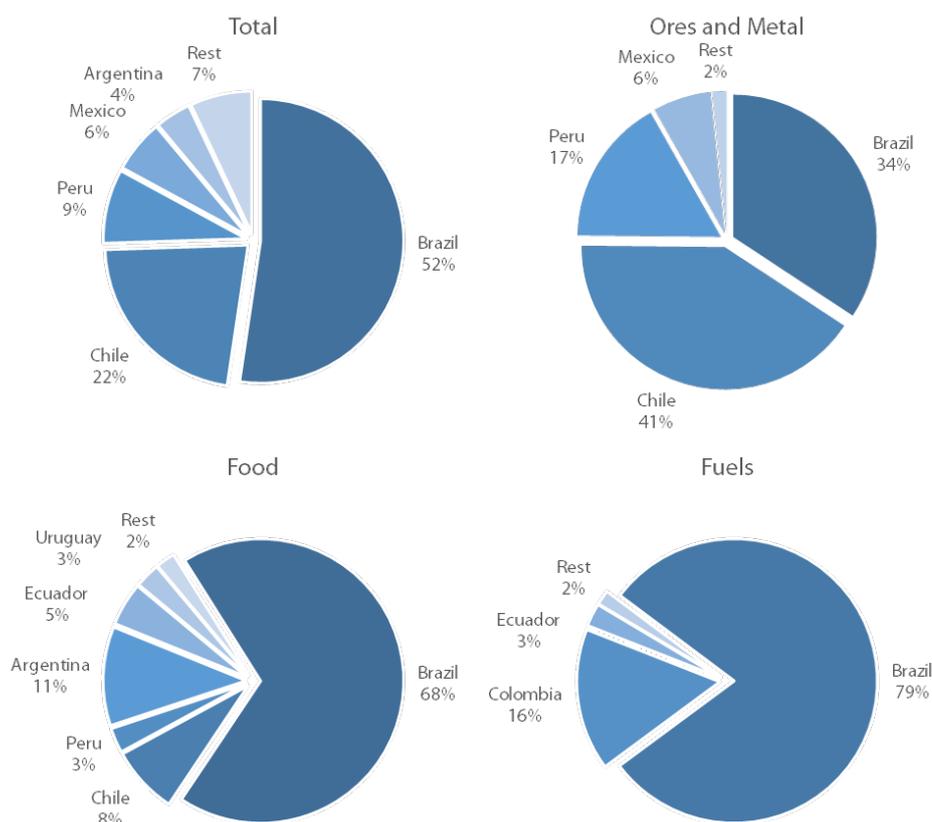
Source: Own elaboration based on UN Comtrade (WITS).

On the country level, Brazil is by far China's most important trade partner. In 2020, Brazil's exports accounted for USD 67.8 billion or 52 % of total exports from LAC countries to China. Chile ranks second with USD 28.7 billion or 22 %, followed by Peru (USD 11 billion, 8 %). Mexico accounts for USD 7.8 billion (6 %), and Argentina for USD 5.2 billion (4 %) of total exports to China. Brazil is a leader in food and fuel

³ If China's import data are used in this case, machinery and transport equipment represents the most important Central American & Mexican export sector (42 %), followed by ores and metals (32 %) and other manufacturers (18 %). Absolute numbers differ, accordingly. China reports USD 16.2 billion worth of Mexican imports in 2020, more than twice the amount Mexico reports in exports to China.

exports. Chile and Peru export predominantly ores and metals, while Argentina has a significant share in food exports (3%) (Figure 3).

Figure 3: Shares of countries in LAC exports to China, 2020



Source: Own elaboration based on UN Comtrade (WITS).

These five countries (Argentina, Brazil, Chile, Mexico, and Peru), together with Colombia, are also the most important trade partners in terms of imports. In 2020, Mexico ranked first with USD 73.5 billion or 41 % of total Chinese imports to LAC countries.⁴ Brazil accounted for USD 36.7 billion (20 %) and Chile for USD 16.5 billion (9 %). Argentina, Colombia and Peru each hold a share of about 5 %. With small deviations, this distribution is also reflected in the main import categories: machinery and transport equipment and other manufactured goods. Looking only at trade in chemicals, Brazil is the main importer (36 %), followed by Mexico (20 %) and Argentina (10 %).

Trade in services

The value of total trade in services between LAC and the rest of the world amounted to USD 287.9 billion, in 2020. With exports of USD 126 billion and imports of USD 161.9 billion, LAC has a deficit with the rest of the world (UNCTAD, 2022). The deficit is caused in particular by South American countries, which ran a deficit in services trade of USD 45.3 billion with the rest of the world. The trade balance of Central American countries & Mexico is almost even (exports USD 41.6 billion; imports USD 42.1 billion). Caribbean countries recorded a trade surplus in services with the rest of the world in 2020: Imports of USD 14.3 billion were more than offset by exports of USD 24.1 billion. Good-related services play a minor role in LAC's total trade in services (2 %). Transport services account for 24 % and travel services for 18 % of total services trade. The

⁴ This time the figures reported by China are considerably lower: In 2020, China reported exports to Mexico to the value of USD 44.8 billion.

largest category is other services (56 %), which – inter alia – includes telecommunication, computer, and information services as well as a wide range of business services. While LAC has a trade deficit in transport services (USD 23.7 billion) and other services (USD 32 billion), it records a trade surplus in travel services (USD 16.6 billion). The latter is attributable to Caribbean countries (+USD 8.8 billion) and Central America & Mexico (+10.2). The trade deficit in the category of other services is mainly due to South America's negative trade balance (-31.5 billion).⁵

3 Chinese foreign direct investment and infrastructure projects in LAC

Before 2000, China showed no significant outflows of capital. The country's priority was rather to attract investment from abroad for the development of its own economy. However, starting in the early 2000s, China has steadily and in a relatively short period of time become a major source of FDI in the global economy (Song, 2019). China's outward FDI (OFDI) rose from less than 1 % of the global OFDI stock in 1990 to 11.3 % in 2019, making the country the third largest source of OFDI after the EU and the US (ECLAC, 2021, p. 77, 80).

The 'OFDI China en ALC'-database (=OFDI *Monitor*) by Red ALC-China records Chinese OFDI transactions in LAC from 2000 onwards.⁶ According to the database, Chinese companies undertook 524 transactions in LAC countries with a total volume of about USD 171.9 billion up to 2021. Of this, only 1 % or USD 1.5 billion went to Central America (without Mexico) and 85 % or USD 145.2 billion to South America. Within South America, Mercosur accounted for USD 76 billion (44 % of total LAC volume). Mexico accounted for USD 16.9 billion (10 %).⁷ Figure 4 illustrates the distribution of Chinese OFDI in the region, including the shares of the most important countries, Brazil, Peru, Chile, Mexico, and Argentina.

A total of 293 or 56 % of China's total OFDI transactions were recorded between 2015 and 2021. Their aggregate value amounts to USD 89 billion. Chinese OFDI has developed very dynamically in recent years, particularly so until 2019. After that, owing *inter alia* to the effects of the COVID-19 pandemic, annual investments declined (see Figure 5). China is, however, not the most important source of FDI in the LAC region. In 2019, FDI inflows from China accounted for only 11.36 % of total FDI received by the LAC region. In 2020 and 2021, these numbers dropped to 10.44 % and 6.15 %, respectively (Dussel Peters, 2022a, p. 4f). This decline arguably has to do with more restrictive foreign lending practices of Chinese banks. ECLAC (2021, p. 87) speaks of a period of great dynamism of Chinese FDI inflows to the region from 2010 onwards, but also points to the still low FDI stock relative to EU or US investment in the region. While in 2018, Chinese inflows accounted for 1.6 % of the region's total inflow, EU inflows accounted for 50 % and US inflows for 22 %. A comparison of the trend of Chinese OFDI in LAC shown in Figure 5 with the overall trend of OFDI holdings in LAC between 2015 and 2021 shows similar patterns. According to UNCTAD data, OFDI stocks

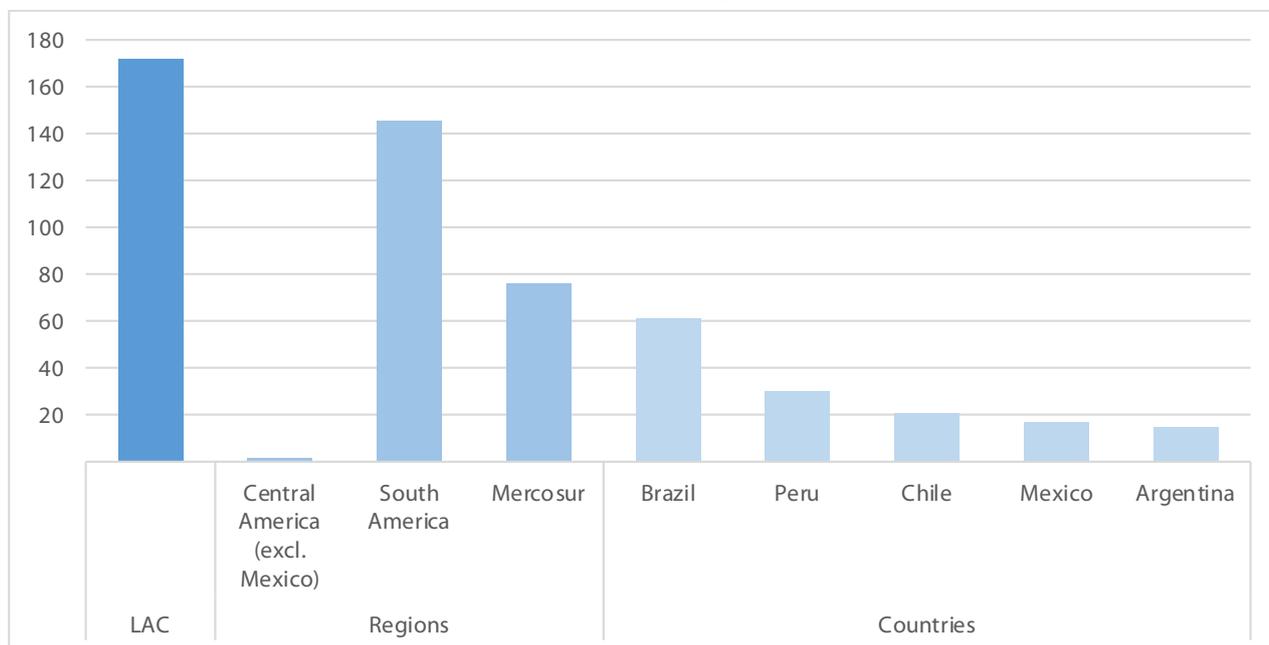
⁵ A regional breakdown of LAC data on trade in services by partner country is not available in UN Comtrade or other international services trade statistics. It is therefore not possible to determine how LAC's services trade with China has developed. In addition, the data on the subcategory of "other services" are incomplete. For this reason, the category is only reported in aggregate terms.

⁶ Official information about Chinese capital flows is highly aggregated and does not allow for a breakdown of China's flows of investment by destination, project or type of instrument (Küblböck, Tröster and Ambach, 2019). The 'OFDI China en ALC'-Monitor by Red ALC-China systematically collects statistics on FDI to LAC countries. There are also others, such as the AEI/Heritage Foundation (n.d.) database. Recent ECLAC publications on FDI in LAC (ECLAC, 2020, 2021) rely largely on databases from the Financial Times (fdimarkets.com) and Bloomberg. Due to different methodologies and definitions, the figures of the respective databases differ. However, trends are the same. We consider the OFDI *Monitor* database the most informative source and mainly refer to its data. The full database is available at <https://www.redalc-china.org/monitor/>.

⁷ Caribbean countries play hardly any role at all, other than as Special Purpose Entities (SPEs). The characteristics of SPEs imply that capital flows do not stop there. Investments rather flow through these entities, enjoying certain local tax incentives and taking advantage of preferential policies. According to Song (2019, p. 20), an average of 90.9 % of Chinese OFDI passed through the Cayman Islands and British Virgin Islands between 2009 and 2016. However, since the OFDI *Monitor* is based on disbursed OFDI, it does not include SPE transactions.

in the region rose from USD 1.61 trillion in 2015 to USD 1.96 trillion in 2017. While stocks were largely stagnant in 2018 (USD 1.95 trillion), they increased to USD 2.17 trillion in 2019 and again fell to USD 2.07 trillion in 2020. 2020, the first year of the COVID-19 pandemic, also saw the lowest inflow of FDI to LAC countries. While inflows ranged from USD 136 billion to USD 159 billion between 2015 and 2019, they fell to USD 86 billion in 2020. In contrast to Chinese OFDI, total OFDI to the region appears to have recovered more quickly: FDI inflows amounted to USD 134 billion in 2021 and OFDI stocks slightly increased to USD 2.14 trillion (UNCTAD, 2022).

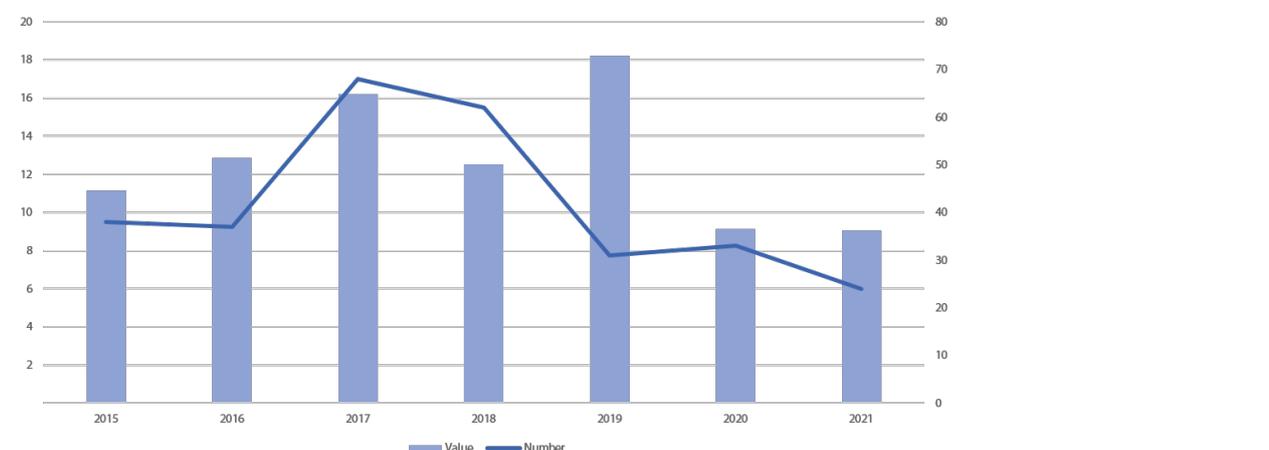
Figure 4: Accumulated Chinese OFDI transactions to LAC regions and countries in USD billion, 2000-21



Source: Own elaboration based on OFDI Monitor.

Brazil has traditionally been the main recipient of Chinese OFDI (Dussel Peters, 2022a). From 2015-21, 35 % of Chinese OFDI in the region were invested in this country. The other main recipients in the period 2015-21 were Chile, Mexico and Peru, where investment increased to a share of 19 %, 16 % and 15 %, respectively. With a share of only 5 %, Chinese OFDI to Argentina decreased considerably in the same period. These figures illustrate a diversification of Chinese OFDI in the LAC region (Dussel Peters, 2022a).

Figure 5: Value in USD billion (lhs) and number of transactions (rhs) of Chinese OFDI in LAC per year, 2015-21



Source: Own elaboration based on OFDI Monitor.

A tendency for more diversification can also be noted on the sectoral level (ECLAC, 2021, p. 94; Dussel Peters, 2022a). On a highly aggregated level, raw materials are still the most important sector in terms of total Chinese OFDI. According to the *Monitor* database, they account for 46 % of investments from 2015 to 2021. However, investments in manufacturing activities (23 %) and services (27 %) increased significantly in this period. Avendano, Melguizo and Miner (2017) see the shift toward services in line with the rising importance of services in China's domestic economy (now more than 50 % of GDP), which resulted in growing confidence in selling service-related products to middle-class consumers in LAC.

On a more disaggregated level, energy was the most important sector in the period 2015-21 (40 % of OFDI), followed by metals, minerals and mining (26 %).⁸ Investments in the energy sector experienced a considerable shift in the recent period from the generation and distribution of fossil fuels to renewable energies (Dussel Peters, 2022a; see also ECLAC, 2021, p. 101). In terms of employment associated with OFDI, transportation (40 %) has been the most significant sector (Dussel Peters, 2022a). In total, the 293 OFDI transactions completed from 2015 to 2021 provided employment to 424,744 people in the LAC region.

Over recent years, there has been an observable trend toward mergers and acquisitions (M&A) in Chinese OFDI. In the period 2015-21, 47 % of all OFDI transactions involved M&A. In 2019 (19 to 12 transactions) and 2020 (20 to 13), M&A transactions outweighed greenfield investments. M&A transactions, it is worth noting, are also significantly higher in volume than greenfield investments. In total, USD 66.45 billion or, on average, USD 485 million per transaction were invested in M&A transactions. In contrast, the figure for greenfield investments was only USD 22.68 billion in total and USD 145 million per transaction. With respect to the mining sector, this trend can be partially explained by the opposition and social conflict associated with greenfield investment (e.g. the copper mines Las Bambas and Toromochó in Peru), whereas M&As only involve a change in ownership of an already existing project (Küblböck, Tröster and Ambach, 2019). It is also noteworthy that the share of public ownership in Chinese OFDI – defined as enterprises owned by the central government, provinces, municipalities and cities – is very high. In 2000-21, public OFDI accounted for 45 % of transactions and about 75 % of the value of OFDI. Also, public OFDI has particularly focused on large capital-intensive transactions (Dussel Peters, 2022a).

A look at infrastructure projects also allows conclusions to be drawn about Chinese influence in the region. Unlike other sources, which tend to conflate OFDI and infrastructure projects, the Red ALC-China project database provides a clearly delineating definition of an infrastructure project as "...a service between a client and a supplier through a contract [...], in which the ownership belongs to the client" (Dussel Peters, 2022b, p. 2). Furthermore – and, again, in contrast to other sources (e.g. ECLAC, 2021) – the 'China Infrastructure Monitor for LAC' (=Infrastructure *Monitor*)⁹ only includes projects that were actually carried out, not those that were simply announced. The latest analysis from the Infrastructure *Monitor* highlights the dynamic development of the past two years: From 2005 to 2021, the region has seen 192 projects worth USD 98.4 billion and creating 673,600 jobs. The years 2020-21 alone accounted for 30 % of these projects by number, 33 % by value and 25 % by employment (Dussel Peters, 2022b). This contrasts with the declining OFDI in the same years. The precise reasons for this remain unclear, but might be partially explained by the growing traction of the Belt and Road Initiative (BRI) in the LAC region, particularly in South America. With Argentina (more recently), Bolivia, Chile, Ecuador and Peru having already joined the BRI, only Brazil and Colombia have not become formal members yet (for an overview of LAC membership in the BRI, see Annex, Table 2).

Regional diversification processes are also reflected in infrastructure projects. While Brazil and Argentina were and are main target countries, Bolivia, Chile, Colombia, Ecuador and Peru also became increasingly important. In terms of sectors, the energy sector remains important but is losing out to transportation

⁸ Note that activities within the sector include extraction as well as manufacturing and services.

⁹ https://www.redalc-china.org/monitor/index.php?option=com_content&view=article&id=438

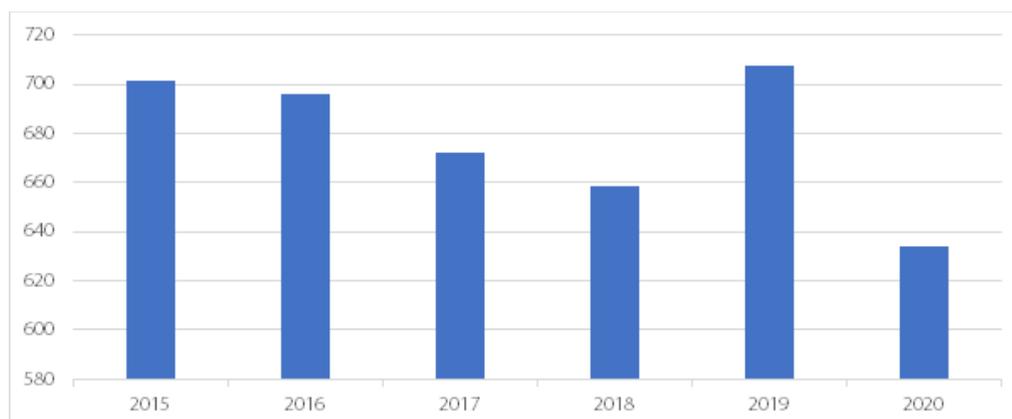
projects (ports, airports, highways and rail). In 2020-21, the transportation sector accounted for 58 % of the value of all infrastructure projects and for 86 % of all jobs created. The energy sector accounted for 30 % and 11 %, respectively (Dussel Peters, 2022b, Table 3). The shift within the energy sector towards comparatively smaller renewable energy projects is also particularly noteworthy (Dussel Peters, 2022b).

Finally, a further important component of China's internationalization strategy is the issuing of loans, mostly on preferential terms (ECLAC, 2021, p. 104). State-to-state loans are primarily extended by the Chinese Development Bank (CDB) and the Export-Import Bank of China (EXIM Bank). Between 2005 and 2021, LAC registered about 100 loans totalling USD 138 billion (Gallagher and Myers, 2022). While loan volumes fluctuate widely per year (see Küblböck, Tröster and Ambach, 2019), China did not extend any new loans through CDB and EXIM Bank to LAC countries in 2021 for the second year in a row (Albright, Ray and Liu, 2022; Gallagher and Myers, 2022). Given the increased investment in infrastructure projects over the same period, this is at odds with the assessment in past years that China itself provides the financing for the implementation of infrastructure projects through these loans (ECLAC, 2021, p. 105).

EU Foreign Direct Investment in LAC

Comparisons to the OFDI activity of EU countries in LAC are not easily possible. This is mainly because of data limitations. For example, Eurostat does not publish any national OFDI data disaggregated at the sector or country level. Nevertheless, several interesting details can be highlighted. In 2020, European OFDI stocks in Latin America (excluding the Caribbean countries) amounted to EUR 634 billion. This represented a decrease compared to 2019 (EUR 707.2 billion). The period 2015-18 saw a general decrease in European FDI stocks from EUR 701.5 billion to EUR 658.2 billion (Eurostat, 2022; Figure 6).¹⁰ Though since 2000 Chinese OFDI in LAC has clearly grown much quicker than EU investment, the FDI stock of the EU is still 3.5 times larger than that of China in 2020.

Figure 6: EU27 FDI stocks in LA, EUR billion, 2015-21



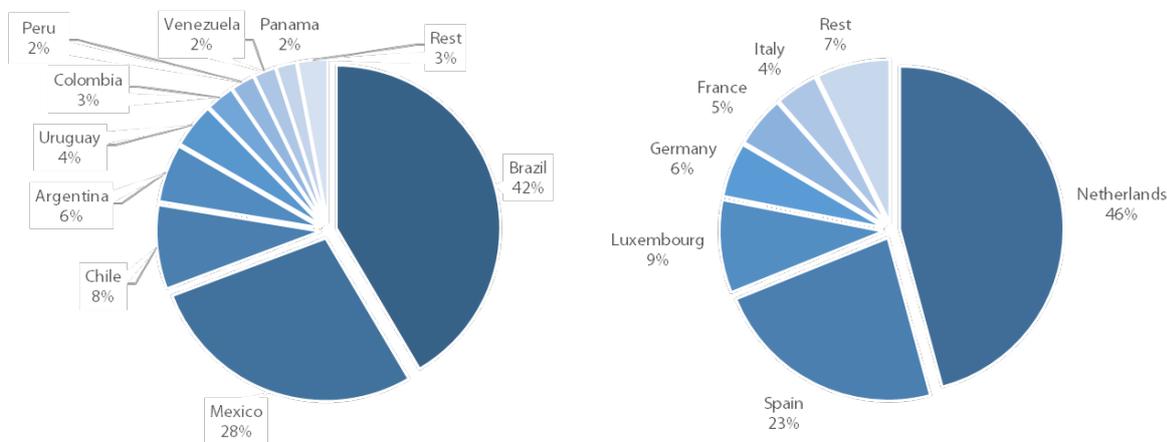
Source: Own elaboration based on Eurostat.

Brazil is not only a main recipient of Chinese OFDI, but besides Mexico has also emerged as a top recipient of EU OFDI. In 2020, Brazil and Mexico accounted for 42 % and 28 %, respectively, of European net OFDI. These two countries are followed by Chile with a share of 8 %, Argentina with 6 % and Uruguay with 4 %. In 2020, the Netherlands were the biggest European investor (46 %), followed by Spain (23 %) and Luxembourg (9 %) (Figure 7). While the high level of Spanish investments can be explained by its historical ties to the LAC region, investments from the Netherlands and Luxembourg have to do with the favourable tax climate offered to transnational companies. Thus, "FDI recorded as originating from these countries does not strictly reflect investments by Netherlands- and Luxembourg-based transnational companies in

¹⁰ Note that the data does not include Caribbean countries.

the region" (ECLAC, 2021, p.37). It does not even mean that investments originated in Europe at all. Differentiating between 'intermediate investors' and 'final controllers', a recent study by the Central Bank of Brazil (2021) indicates, for instance, that the Netherlands' OFDI stock in Brazil that falls under the 'intermediate investor criterion' amounts to USD 108.1 billion, while FDI under the 'final controller criterion' is only USD 19.6 billion. An earlier study by the Central Bank of Brazil suggests that 80 % of investments of Chinese origin entering the country in 2016 arrived through third countries, mainly the Netherlands and Luxembourg (ECLAC, 2021, p.87).

Figure 7: Main recipients (left, 2020) and source countries (right, 2020) of EU27 OFDI stocks



Note: Data for source countries do not include OFDI in the remaining countries, but only the top nine LA recipient countries.

Source: Own elaboration based on Eurostat.

As mentioned, there are no data on OFDI by economic sector or number of transactions and jobs created at the EU level. However, some national OFDI statistics do provide employment data. For example, German data shows that in 2020, 2,250 enterprises with German capital interests accounted for 665,000 jobs in Central and South American countries. Disaggregated data is also available for investment from Spain. It indicates a generated employment of 5,430,000 jobs for the year 2020. The data also provides a sectoral breakdown of Spain's OFDI stocks. In 2020, financial services accounted for 30 % and telecommunication for 10 % of OFDI by value. The electric power, gas, steam and air supplies sector accounted for a further 10 %. The extractive sector is also important, with crude oil and natural gas accounting for a further 7 %. The manufacturing of iron and steel products accounted for 4 %, while the extraction of metallic minerals stood at only 1 %.¹¹

4 Indirect impacts of closer LAC-China trade and investment relations

Besides the direct impacts that China exerts on the economies of LAC, Chinese influence has given rise to several important indirect consequences. A concern for some Latin American countries has been the threat of increased competition from China in third markets, particularly since its accession to the WTO in 2001 and the removal of textile & apparel quotas under the Multi Fibre Agreement (MFA) at the start of 2005. China has been seen as a competitor in goods markets for countries exporting labour-intensive manufactured goods – an area in which China is highly competitive. Furthermore, however, there are concerns that FDI is also being diverted from Latin America to China, especially given the massive inflows

¹¹ Own calculation based on data retrieved from <https://www.bundesbank.de/en/statistics/external-sector/direct-investment> (Germany) and http://datainvex.comercio.es/principal_invex.aspx (Spain) (Accessed 15 September 2022).

to China since the early 1990s. Secondly, China's emergence as a global trading partner has had an effect on the terms of trade (ToTs) between primary commodities and labour-intensive manufactured goods. The booming demand for agricultural and mineral products (including oil) in China contributed to rising world market prices for primary commodities in the second half of the 2000s, although, on the other hand, the massive growth of Chinese production of labour-intensive manufacturing has tended to push down the prices of such manufactured goods (Jenkins, Dussel Peters and Moreira, 2008). Thirdly, increased economic relations between Latin America and a much larger economy such as China will have repercussions on the economic structure and consequently will affect the growth dynamics of Latin American countries, potentially leading to patterns of asymmetrical interdependence.

How these effects play out in detail can be explored by using model simulations. Afonso et al. (2021) simulate the effects of a 10 % growth in China's capital stock on trade with the LAC region. The effects of the simulated Chinese growth on the Latin American countries lead to a reduction in industrial output and an increase in the production of primary products and services in the LAC region, notwithstanding individual exceptions such as Costa Rica and, to some extent, Mexico, given their specialisation in low to medium-tech manufactured products. Thanks to the commodity price boom in the late 2000s, the ToTs of the LAC region improved temporarily, resulting in higher imports of consumption goods and a more solid balance of payments situation. The trend towards deindustrialisation might, however, undermine the long-term competitiveness of the LAC economies, as productivity growth and technological progress are closely associated with industrial development. That major countries in the region indeed suffer from a trend toward "premature deindustrialization" (Rodrik, 2015) is confirmed by a CEPAL study for the cases of Argentina, Brazil and Chile. Chile, for example, increased their specialisation in commodities, resource-based manufacturing and low productivity services to the detriment of their manufacturing industries. The situation in Mexico demands a deeper analysis, with deindustrialisation having abated in the last two decades (Castillo and Neto, 2016).

The influence of China on overall LAC economic performance has clearly increased over the last four decades. Various studies (Cesa-Bianchi et al., 2011; Chiliatto-Leite, 2021) show that growth dynamics in the LAC region, and particularly in South America, have become more dependent on the Chinese economy. In Central America & Mexico, however, GDP growth is strongly linked to growth dynamics in the United States, as a consequence of the integration of US-led maquiladora value chains (e.g. in automobiles and electronics) following the 1992 North American Free Trade Agreement (NAFTA).

This leads directly to the first of the questions raised above, that is, the potential crowding-out of Latin American producers by Chinese competition, both in its domestic and foreign markets. On the basis of a comprehensive literature review, Jenkins et al. (2008) conclude that Chinese competition affects more countries and more sectors than is often recognised, and the threat to Latin American exports is real and likely to persist. The analysis by Gallagher and Porzecanski for the period 2000-06 finds that China gained export market share directly from LAC producers, and that if both gained market share, the growth rate of Chinese producers outpaced that of its LAC competitors. The competitive threat to extra-regional LAC exports was, however, higher than for intra-regional LAC exports (Gallagher and Porzecanski, 2010).

In sum, while LAC profited from expanded economic interchange with China due to positive terms of trade effects stemming from higher export prices for commodities and lower prices for imported manufactures and capital goods, the long-term implications of the asymmetrical dependence of LAC countries on China remain somewhat in doubt. There are some indications that China has indirectly contributed to the deindustrialisation process present in most countries of South America. More importantly, LAC countries have not been able to upgrade in many global value chains that rely on inputs from the region, such as e.g. soybeans, minerals, fish meal, etc., with negative effects on value-added, productivity and technological development (Dussel Peters, 2021). While trade between LAC and China is largely complementary, the pattern of trade specialization indirectly induced by China seems problematic. Given cumulative capability

building, China's success in increasingly technology-based products with strong learning externalities places it on a higher growth path than specialization in "simpler" goods, as in LAC. China may thus negatively affect LAC's technological upgrading in exports and industrial production. The issue is hence not so much current competition, as the "spaces" open for LAC in the emerging technology-based world (Lall, Weiss and Oikawa, 2008). Finally, it should be noted that growing interdependencies with China have contributed to diverging business cycles between South America, on the one hand, and Central America & Mexico, on the other. This will be an impediment to stronger intra-regional economic integration in the future.

5 Chinese influence in the LAC region

Intensified economic relations between China and LAC have been fostered by increased political cooperation over the last two decades. A major initial impetus towards this cooperation was provided by the 2006 formation of the BRICS group of countries and the political initiative by the left-wing governments predominant in the LAC region during the early 2000s (particularly in Brazil, Argentina and Venezuela) to improve intra-regional cooperation while at the same time enhancing south-south cooperation. The export-dependent economic models pursued by the centre-left governments, while reducing poverty and inequality to some extent, ran into difficulties once commodity prices stagnated and growth slowed in the early to mid-2010s. As a consequence, Latin America as a whole achieved economic growth of just 2.2 % a year on average between 2010 and 2020, well below the 3.1 % global average (Winter, 2022).

Economic stagnation had significant political repercussions. The period 2014-19 saw a political turnaround with liberal and right-wing governments assuming power in most countries of the region, including Brazil, Argentina, Chile and Ecuador. Internal divisions and fragility increasingly characterised the major regional cooperation fora, including Mercosur, the Andean Community, OAS, and in particular ALBA and Unasur. The latter was effectively dissolved in 2019-20. Instead, Prosur, as a new regional initiative, was formed on the initiative of Chile and Colombia in March 2019, albeit with modest results so far (Ominami, 2021). Much of the political cleavage in the region is related to the situation in Venezuela, which resulted in increasing ideological polarisation between supporters and opponents of the Venezuelan regime. A further destabilising factor has been the migration crisis in Central America, with the Trump administration effectively closing the Mexican-US border and exacerbating a migration crisis in a region already struggling with a security crisis related to the growing influence of the drug economy. All in all, intra-regional cooperation had become almost non-existent by the end of the decade, a situation frequently described by analysts as "vaciamiento latinoamericano" or institutional emptiness (Gonzalez et al., 2021).

Against this background, many governments in the region have come to see enhanced economic and political relations with China as strategically important. In economic terms, the relationship offered the option of increasing export revenues, technology transfer and an additional source of external finance. In political terms, this translated into less economic dependence on traditional export markets in the US and Europe and more financial breathing space, given that relations with the IMF and other international financial institutions are perceived in the region as difficult. Most LAC countries have become members of China's belt and road initiative (BRI) over the last ten years, with Argentina joining in February 2022. In addition, an increasing number of countries are in the process of joining the Asian Infrastructure Investment Bank (AIIB), particularly from South America (including Brazil, Uruguay, Ecuador, as well as Chile, Argentina and Peru who have been full members since 2022). With membership in these organisations, bi-regional economic relations become institutionally consolidated, and LAC countries eventually gain access to additional sources of finance. Most recently, Argentina and China signed a Memorandum of Understanding for USD 23 billion in financing (Albright, Ray and Liu, 2022).

On the other side of the relationship, President Xi Jinping has moved to intensify China's relations with Latin America via a diplomatic offensive, including the bi-regional China-CELAC summits as well as

enhanced institutional cooperation, as seen, for example, by the “1+3+6” initiative and two joint action plans for the periods 2019-21 and 2022-24, respectively (CELAC, 2015, 2019, 2021). The “1+3+6” initiative, for instance, included a cooperation plan for the period 2015-19, defining specific objectives for expanding bilateral trade, investment and financial cooperation, as well as promoting thematic cooperation in the six areas of energy and raw materials, infrastructure, manufacturing and scientific-technical innovation.

In addition to economic and political cooperation, China aims to consolidate its relationship with Latin America also by means of employing tools of soft power. This involves, for instance, scientific and technological cooperation. In the strategically important sector of space technology, countries such as Bolivia, Ecuador, Nicaragua and Venezuela have recently launched their own programmes with support from China. Against the background of the COVID-19 pandemic, which has hit the LAC region particularly hard, with 68.5 million infections and 1.68 million deaths reported as of May 2022, China has stepped up its aid to LAC under the framework of the Health Silk Road (HSR). The concept of the HSR was proposed by China’s National Health Commission in 2015 (Liu, Huang and Jin, 2022). Under the HSR, China committed itself to promoting cooperation in the public health system among the member countries of the BRI. In the LAC region, China delivered medical supplies and vaccines in the equivalent amount of some USD 215 million (as of February 2021) and offered a USD 1 billion loan facility for the purchase of Chinese vaccines. This resulted in a strong expansion of LAC purchases of Chinese vaccines in 2021/22, with LAC contracts with Chinese vaccine manufacturers amounting to over 1.5 billion doses as of January 2022 (Albright, Ray and Liu, 2022). Also, local manufacturing facilities for the Sinovac vaccine have been set up in Brazil, Chile, Colombia and Mexico (Ray, Albright and Wang, 2021). The pragmatic approach of China with respect to responding to the immediate needs of the countries of the Global South, including in Latin America, is seen as the key feature of China’s approach to soft power, layered on top of its expansive economic engagement (Repnikova, 2022). Apparently, the approach has been quite successful: in a survey conducted by the PEW Research Center in Argentina, Brazil and Mexico in 2019, about half of respondents reported having a favourable image of China; only about a quarter expressed negative views (Silver, Devlin and Huang, 2019).

Yet, China also faces difficulties in Latin America. Some countries have been involved in trade disputes with China, China’s ambitious infrastructure projects have faced some resistance, particularly from environmental groups, e.g. in Argentina and Peru (Slipak, 2022). In addition, projects have been criticised for not creating local jobs, with workers often having been brought in from China. Also, servicing increasing levels of bilateral debt might prove difficult for LAC countries, as the global economic situation is severely impacted by the war in Ukraine and interest rates in advanced countries are on the rise. Renegotiations of existing debts have already taken place with Ecuador in 2020/21 and are pending with Argentina and Surinam as of March 2022 (Albright, Ray and Liu, 2022). Finally, China’s engagement in the region is hampered by the lack of strategic vision on the part of LAC countries. Very few LAC countries, that is, only Mexico and Brazil, have set up an explicit agenda vis-à-vis China.

Over the coming years, it is widely expected that the trend of Chinese OFDI towards commodities crucial for renewable energy development will intensify. In the period 2017-21, LAC exports to China of aluminium, produced from Caribbean bauxite deposits and having numerous renewable energy applications, grew by a factor of 28 in comparison to the period 2012-16. Exports of lithium carbonate, a key component for battery production, grew threefold over the same timeframe. Exports of balsa wood from Ecuador, necessary for wind turbine blades, have grown by some 57%. It is expected that China will leverage its strategic investment approach combining state finance, commercial lending and investment to develop new supply chains for these materials (Chin and Gallagher, 2019).

With the recent electoral successes of centre-left parties in Latin America, in particular in Chile, Colombia and most recently with the re-election of former President Luiz Inácio Lula da Silva in the Brazilian presidential elections in October 2022, the left-wing governments in the LAC region have become significantly reinforced. In terms of foreign policy strategy, this will arguably translate into attempts to forge a renaissance of both intra-regional and south-south cooperation, as well as a general policy stance of “active non-alignment” to either of the geopolitical rivals, the United States and China (Fortin, Heine and Ominami, 2020).

6 Conclusion

Against the backdrop of China's growing economic and political influence in the LAC region, the EU will need to adjust its strategy to the structural changes in the socio-political environment in LAC. The current strategy based upon enhanced economic cooperation in the context of existing and pending bilateral trade agreements (e.g. the EU-Mercosur Association Agreement (AA), the EU-Chile AA, and the EU-Mexico AA) will arguably have to be complemented by a more comprehensive approach that caters to the new LAC governments' agenda to promote sustainable development. This will involve two priority areas for cooperation: The first area relates to productive development and technological upgrading for a socially inclusive green transition. With the EU as a leader in clean technologies, this should involve a strategic partnership in the field of research and innovation. This includes technological cooperation and technology transfer for (i) promoting the shift to renewable energy, (ii) increasing energy efficiency and reducing carbon emissions from industrial activity, and (iii) expanding local technological capabilities with respect to fostering the circularity of economic processes. The second priority area relates to the necessary sustainability transition in the extractive sectors of the LAC economies. In response to strong popular resistance against the prevailing intensive resource extraction, LAC governments (including the new centre-left governments in Chile, Colombia and Brazil) have committed to a stronger human rights as well as environmental agenda. In contradistinction to Chinese engagements in mining projects, the EU could particularly offer raw materials partnerships that include a strong emphasis on human rights and environmentally sustainable mineral extraction and mining. The EU could support cleaner and socially responsive mining practices, for instance, in the framework of green finance initiatives and through expanded concessional funding commitments of European development banks (e.g. the EIB, EBRD) as well as European Development Finance Institutions. Thus, the interests of the EU for securing access to minerals critical for the green transition could be coupled with a serious offer to jointly develop a sustainable mining agenda. Similarly, the efforts of the EU to reduce imports of goods linked to deforestation should be linked to a strong commitment to support the LAC governments' efforts to promote sustainable forest governance and respect for the rights of indigenous people.

In contrast to China's more bilateral approach, the EU could finally reach out to LAC governments to join forces to promote a new multilateralism. Against a panorama of growing geopolitical tensions and a crisis of multilateral institutions, it is in the common interest of both regions to propose cooperative solutions to global problems, including for instance initiatives on biodiversity conservation, tax cooperation, illicit financial flows or on global health issues. Given the new governments' declared commitments on human rights, social policies and sustainable development, opportunities for further cooperation on advancing these and other issues of mutual interests at the international level might form a third core element of a renewed partnership between the EU and LAC.

Annex

Table 1: Chinese Free Trade Agreements and negotiations with LAC countries

Country	Year	Legal status	Main contents/State of play
Chile	2005	Amended in 2008 and 2019	<p>The agreement is focussed on enhancing market access for commodities and manufactured products. Under the Agreement, China and Chile will extend zero duty treatment phase by phase to cover 97 % of products in ten-year time. The agreement provided immediate duty-free entry for 92 % of Chile's exports to China, including Chile's most important agro-exports (apples, grapes, plums, chicken products, cheese, and cherries). Other agro-industrial exports (e.g. fruits and fish) were to be phased in over ten years. On the import side, 50 % of Chile's imports from China were granted duty-free access at the outset, with goods in 152 "sensitive product" lines (including wheat, flour, sugar, some textiles, and some major appliances) were completely excluded.</p> <p>In April 2008, a Supplementary Agreement on Trade in Services was signed.</p> <p>In 2019, a further upgrade included chapters on rules of origin, customs procedures and trade facilitation, electronic commerce, competition, environment and trade, economic and technical cooperation, and enhanced commitments on trade in services.</p>
Peru	2009	Upgrading negotiations since 2018	<p>The agreement is focussed on enhancing market access for commodities and manufactured products. Chinese tariffs on 99 % of Peru's exports to China are covered, with 83.5 % entering the Chinese market duty-free at the outset of the agreement. Specific goods such as coffee, wheat, rice, corn, sugar and vegetable oils, which accounted for about 1 % of Peru's exports, are excluded. In return, 68 % of China's exports to Peru were granted immediate market access, with 592 sensitive product lines – including textiles, garments, shoes, and metal mechanics, which account for about 10 % of China's exports to Peru, being excluded.</p> <p>Upgrading negotiations cover trade in services, investments, intellectual property, e-commerce, competition policy, customs procedures, trade facilitation and rules of origin.</p>
Costa Rica	2011	–	<p>The agreement features both market access on commodities and manufactured goods, and market access in selected services sectors. Over 90 % of goods trade between China and Costa Rica will enjoy zero tariffs on a stage-by-stage basis. For China, goods trade covers products from textile industry, light industry, machinery, electronics, vegetables and fruits, automobiles, chemicals, hide and leather, and for Costa Rica, it covers coffee, beef, pork, pineapple juice, frozen orange juice, jam, fish powder, minerals and hides. In service trade, 45 service sectors and sub-sectors of Costa Rica, including telecommunication services, commercial services, construction, real estate, distribution, education, environment, computers and tourism services, and 7 service sectors and sub-sectors of China, including computer services, real estate, market research, translation and interpretation and sport, will further open to each other. The agreement also contains chapters on intellectual property rights, trade relief, rules of origin, customs procedures, technical barriers to trade, health and plant inspection and quarantine and cooperation.</p>
Colombia	–	Announcement of Joint Feasibility Study in 2015	<p>China and Colombia agreed on conducting a feasibility study on a FTA in May 2015 and expressed the interest in signing a FTA. Further results have since been pending.</p>

Panama	–	Negotiations since 2018	Five rounds of negotiations have taken place since July 2018, with the most recent to date in April 2019. Dossiers covered trade in goods, trade in services, financial services, investment, rule of origin, customs procedures and trade facilitation, trade remedy, trade and economic cooperation, as well as legal issues.
Uruguay	–	Preliminary discussions since 2021	On different occasions, China and Uruguay talked about intensifying their relations with a peak in 2021-22 and the open declaration of wanting to negotiate an FTA. These negotiations, however, are hampered by Uruguay's membership in the MERCOSUR bloc and the opposition by Argentina and Paraguay. Given the latter two countries' opposition, a bilateral agreement between China and Mercosur is not likely in the near future, while a separate agreement between China and Uruguay would violate Mercosur rules and exacerbate tensions amongst Mercosur members.
Ecuador	–	Negotiations since 2022	A joint feasibility research for a FTA was initiated by Ecuador and China in September 2021, and was concluded in January 2022. A first round of negotiations took place in July 2022. In August 2022, Ecuador's Production, Trade and Investments Minister announced that Ecuador seeks to achieve an agreement by the end of 2022.

Sources: Ellis (2022), MOFCOM (2020, 2022a/b), Ecuador Times (2022), TeleSUR (2022), Wise (2016).

Table 2: LAC countries that have joint the BRI by signing a Memorandum of Understanding (as of March 2022)

South America	Central America & Mexico	Caribbean
Argentina	Costa Rica	Antigua and Barbuda
Bolivia	El Salvador	Barbados
Chile	Panama	Cuba
Ecuador		Dominica
Guyana		Dominican Republic
Peru		Grenada
Suriname		Jamaica
Uruguay		Trinidad and Tobago
Venezuela		

Source: Green BRI Center (2022)

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PE 702.572
EP/EXPO/INTA/FWC/2019-01/LOT5/2/C/14

Print ISBN 978-92-846-9964-3 | doi: 10.2861/445832 | QA-03-22-188-EN-C
PDF ISBN 978-92-846-9965-0 | doi: 10.2861/282018 | QA-03-22-188-EN-N